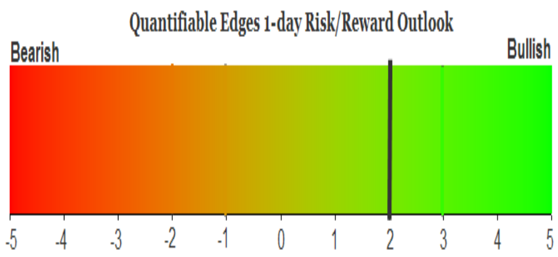
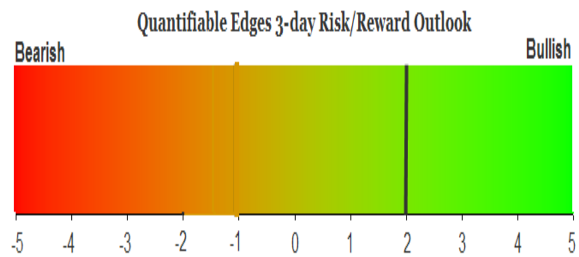
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 15, 2011 Volume 4 Issue 50

Market Overview





Tonight's Research Points

- SPY bars like Monday with unfilled gaps, 10-day lows and a close > open typically lead to higher prices the next day.
- Fed Days are positive and when they come with an unfilled gap down and a 3-day low they are especially bullish.
- Disasters such as the Kobe earthquake and the Chernobyl nuclear accident caused only minor pullbacks in the US market.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook
The Bottom Line

Evidence is suggesting a bounce but risks are elevated due to events overseas. I'm holding firm on my ½ size index long but not looking to increase exposure until I see more compelling evidence that the selling capitulating or reversing.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

Summary of Recent Active Studies (see http://QuantifiableEdges.blogspot.com or Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move
Active				
March 15, 2011	Unfilled gap 10-low. Close > open.	1 day	Bullish	
March 15, 2011	Unfilled gap down pre-Fed Day	1 day	Bullish	
March 14, 2011	Sweet spot bounce	1-5 days	Bullish	3.10%
March 14, 2011	Outside day frm sh-term low in uptrend	1-6 days	Bullish	2.00%
March 14, 2011	March Op-ex Week	1-4 days	Bullish	1.70%
March 11, 2011	Triangle Breakdown > 200ma	1-3 days	Bullish	
March 11, 2011	20-day low. High vol. Lrg drop. >200.	1-7 days	Bullish	2.65%
Active - Long Term				
March 11, 2011	Triangle Breakdown > 200ma	3-4 weeks	Bullish	
March 2, 2011	Outside 2 days and 3-day low close	4-10 days	Bullish	
November 22, 2010	High number of POMO Days recently	int term	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
March 2, 2011	1% drop and decliners 2x advancers	1-9 days	Bullish	3.00%

If the avg max move is achieved the study will appear in ***bold italic blue*** and no longer be active.

The Evidence

International worries dominated trading on Monday. A large gap down started the day. A morning rally showed no legs and then the market rolled over to new pullback lows. Losses were trimmed in the afternoon though and the damage wasn't great to the averages. The SPX and Russell both lost 0.6% while the Nasdaq suffered a 0.5% decline. Breadth was weak as the NYSE Up Issues % came in at 32% and the Up Volume % was 30%. Total NYSE volume rose over Friday's level but was not particularly high.

A few studies and patterns appeared Monday that warranted a closer look. SPY left an unfilled gap down but finished in the upper end of its range. A broad study from 2008 suggested this is typically followed by some upside. I made the parameters a bit more specific to the current situation to see what the current pattern may be suggesting. The study below examines gaps down in uptrends that lead to new lows before reversing above the open, but not high enough to close the opening gap.

SPY gaps down, makes a 10-day low and then closes above the open but never fills its opening gap. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1993 - present.									
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	5,873.25	11	8	3	72.73	1,525.81	-2,111.07	0.72	1.93	533.93
4	251.11	11	7	4	63.64	1,139.91	-1,932.06	0.59	1.03	22.83
3	3,657.44	11	8	3	72.73	965.25	-1,354.86	0.71	1.90	332.49
2	7,224.44	11	8	3	72.73	1,255.50	-939.86	1.34	3.56	656.77
1	7,997.07	11	9	2	81.82	1,047.12	-713.51	1.47	6.60	727.01

There have been fewer instances than I thought there might be. While results are borderline with the low number of instances the early indication appears to be a possible upside edge. Below I have listed all the instances for anyone that wants to take a closer look.

SPY gaps down, makes a 10-day low and then closes above the open but never fills its opening gap. Close > 200ma. Buy on close. Sell next days close. $100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
05/19/95	Buy	$52.10	1.09%	$1,247.35
05/22/95	Sell	$52.67		$0.00
09/27/95	Buy	$58.17	0.74%	$739.17
09/28/95	Sell	$58.60		($17.19)
10/10/95	Buy	$57.88	0.36%	$362.67
10/11/95	Sell	$58.09		$0.00
04/08/96	Buy	$64.39	(0.39%)	$403.78
04/09/96	Sell	$64.14		($574.61)
12/06/96	Buy	$74.31	1.44%	$1,492.95
12/09/96	Sell	$75.38		$0.00
08/11/98	Buy	$106.88	1.69%	$1,870.00
08/12/98	Sell	$108.69		$0.00
08/21/98	Buy	$108.56	0.64%	$1,270.98
08/24/98	Sell	$109.25		($230.25)
09/02/99	Buy	$132.25	2.81%	$3,046.68
09/03/99	Sell	$135.97		$0.00
11/17/03	Buy	$104.93	(1.04%)	$495.56
11/18/03	Sell	$103.84		($1,172.19)
03/07/06	Buy	$127.97	0.21%	$367.07
03/08/06	Sell	$128.24		($616.99)
11/27/09	Buy	$109.46	0.44%	$675.62
11/30/09	Sell	$109.94		($401.72)

Another possible edge is suggested by the fact that tomorrow is a Fed Day. As most everyone who has read my stuff for a while knows, Fed Days have long suggested a bullish edge.

In the 12/14/10 Subscriber Letter I showed SPX returns on Fed Days and broke it out by whether the SPX was trading at a 20-day high the day before the Fed Day or not. The bottom line was that returns with the SPX already at new 20-day highs were inconsistent but when the SPX is not at a new high Fed Days have shown a bullish tendency. If you'd like to read all the details, you can check out the 12/14/10 Letter in the archives.

For those who don't want to read the whole thing, since we are obviously well below a 20-day high, I have updated those results below.

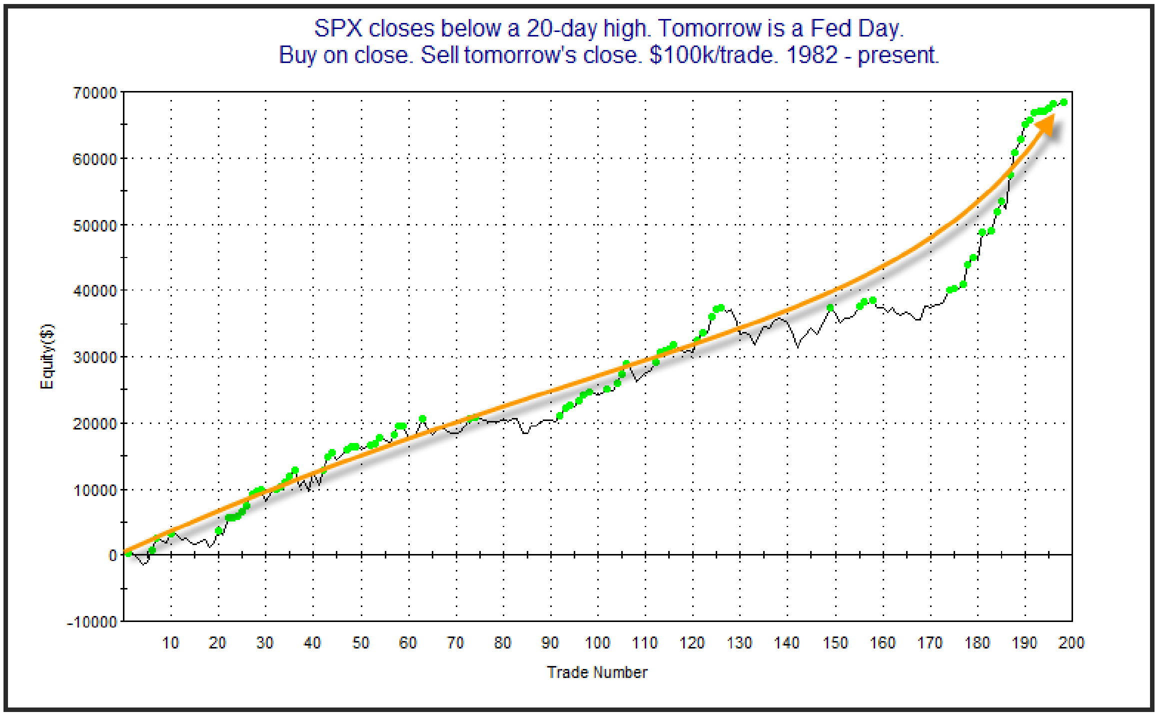
SPX closes below a 20-day high. Tomorrow is a Fed Day.
Buy on close. Sell tomorrow's close. $100k/trade. 1982 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$68,352.93	Profit Factor	2.36
Gross Profit	$118,567.07	Gross Loss	($50,214.14)
Total Number of Trades	198	Percent Profitable	62.12%
Winning Trades	123	Losing Trades	75
Even Trades	0		
Avg. Trade Net Profit	$345.22	Ratio Avg. Win:Avg. Loss	1.44
Avg. Winning Trade	$963.96	Avg. Losing Trade	($669.52)
Largest Winning Trade	$5,130.15	Largest Losing Trade	($2,442.96)

Results here appear solidly bullish. Below is an equity curve to see how the edge has played out over time.



While not a straight line, the constant upslope serves as confirmation of the numbers.

Lastly, I decided to see what would happen if we combined an unfilled gap down and short-term low during an uptrend with a looming Fed Day. There have only been 9 instances, and they are all listed below.

SPY leaves an unfilled gap down and makes a 3-day intraday low. Close > 200ma. Tomorrow is a Fed Day.
Buy on close. Sell X days later. $100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
03/21/94	Buy	$46.85	0.26%	$469.48
03/22/94	Sell	$46.97		($213.40)
12/18/95	Buy	$60.63	1.07%	$1,187.28
12/19/95	Sell	$61.28		($82.45)
03/15/04	Buy	$111.20	0.53%	$773.14
03/16/04	Sell	$111.79		($323.64)
09/20/04	Buy	$112.47	0.44%	$889.00
09/21/04	Sell	$112.96		$0.00
09/19/06	Buy	$131.81	0.53%	$727.68
09/20/06	Sell	$132.51		$0.00
05/08/07	Buy	$150.75	0.27%	$510.51
05/09/07	Sell	$151.16		($251.94)
09/17/07	Buy	$148.10	2.94%	$2,970.00
09/18/07	Sell	$152.46		$0.00
08/11/09	Buy	$99.73	1.07%	$1,833.66
08/12/09	Sell	$100.80		($220.44)
04/27/10	Buy	$118.48	0.76%	$1,012.80
04/28/10	Sell	$119.38		($177.24)

The average intraday runup was 1.15% while the average intraday drawdown was just -0.14%. The average 1-day performance was 0.875%.

Instances are a bit low, but all of them led to higher prices the next day and max run-up/drawdown stats were heavily skewed to the upside.

So that is the evidence as of Monday's market close. The market is continuing to form patterns that suggest a bounce is likely. News overseas tonight has been extremely scary as the situation in Japan has worsened. The Nikkei is down close to 13% as I type and the SP futures are down over 2%. First I'll discuss the Aggregator chart below. After that I will give my take on the unfolding situation.

I have updated the Aggregator chart below.

The green Aggregator line is again very strongly above 0. The positive value means the net expectation from the Active Studies List is for upside over the next few days. As has been the case lately, all the active short-term studies remain bullish. Meanwhile the black Differential line is now very high. Readings above 0 mean the SPX has underperformed expectations over the last few days. So net expectations are for upside and the SPX has underperformed recent expectations. Historically this has provided an upside edge. It can be seen on the chart whenever both lines are above zero. Due to this the Aggregator System remained long at the close.

Based on the current active studies the green Aggregator line is set to stay above 0 on Tuesday. This could change should strong bearish evidence emerge. Meanwhile, the Differential Pivot will be 1,302.18. This is a little less than 0.5% above Monday's close. For the Differential Line to flip negative the SPX would need to close up at least this much.

As I mentioned earlier international crisis are trumping typical historical reaction to price action and seasonalities. Let me first put the current action into some context.

On January 17, 1995 the Kobe earthquake shook Japan. Horrific damage was done and over the next several days, weeks, and even months the Japanese stock market took a large tumble in excess of 25%. In the US there was very little market reaction. It took the form of a 3-day pullback of about 2% before rebounding and continuing on a strong bull run.

On April 26, 1986 the Chernobyl nuclear meltdown occurred in the Ukraine. It was the worst nuclear power plant accident in history. Over the week following this accident the SPX declined as much as 3.5%. It then steadied itself for a couple of weeks before beginning a rally to new highs.

It's very difficult to measure one disaster against another and there is not much historical precedent for what is occurring in Japan. Add to that the current Mideast turmoil and we find ourselves in an environment where fear can quickly spike. In the past somewhat similar foreign events have not caused large-scale selloffs in US stocks. With the news so scary a downside overreaction followed by a sharp rebound seems reasonable. Timing this overreaction from a swing trading perspective is a difficult thing. I expect we will likely see some sort of rebound in the next few days. The rebound may start from a much lower level than the SPX is currently at. I am not yet inclined to ramp up my holdings any further than they already are. For that to happen I would like to see compelling evidence of capitulation. Such evidence could come in the form of a spike in the CBI or perhaps a very sharp rise in the VIX.

It is difficult to know where the market will open tomorrow, or how low the futures may drop in the overnight interim. Personally, I may consider attempting day trade entries on the long side in the next day or so. I would not encourage traders to do this unless they are comfortable day trading and can be nimble with their trades.

In the February 2, 2009 blog I showed a table that listed all gaps down of at least 2% in the SPY. In that table I noted how long it took before the SPY managed to close above the gap down open. Since we are down about 2% tonight I have updated that table below. I find it notable that in 40/43 instances (93%) a close above the gap down open occurred within one week.

SPY Gaps Down 2+%		
Instance	**Date**	**Closed >= Gap Open (Up to 5 days)**
1	April 4, 1994	same day
2	June 24, 1994	1 day later
3	March 8, 1996	1 day later
4	April 8, 1996	same day
5	December 6, 1996	same day
6	October 28, 1997	same day
7	September 10, 1998	same day
8	September 17, 1998	3 days later
9	September 21, 1998	same day
10	October 8, 1998	same day
11	January 13, 1999	same day
12	May 14, 1999	3 days later
13	March 13, 2000	same day
14	April 27, 2000	same day
15	March 14, 2001	same day
16	September 17, 2001	same day
17	September 21, 2001	same day
18	June 26, 2002	same day
19	July 24, 2002	same day
20	January 22, 2008	same day
21	January 23, 2008	same day
22	March 17, 2008	same day
23	September 15, 2008	1 day later
24	September 16, 2008	same day
25	September 17, 2008	1 day later
26	October 6, 2008	**NO**
27	October 8, 2008	3 days later
28	October 10, 2008	same day
29	October 15, 2008	3 days later
30	October 22, 2008	4 days later
31	October 24, 2008	same day
32	November 11, 2008	2 days later
33	December 1, 2008	4 days later
34	December 3, 2008	same day
35	December 12, 2008	same day
36	January 23, 2009	same day
37	February 17, 2009	**NO****
38	February 27, 2009	**NO**
39	March 5, 2009	3 days later
40	March 30, 2009	2 days later
41	November 27, 2009	same day **
42	May 20, 2010	5 days later
43	May 25, 2010	same day
**U.S. Holiday when gap occurred represented 2 days overseas trading.		

One last thing to mention here before I head to bed. Should we get a scary selloff in the next day or so and a spike in the VIX, it could possibly be played by going long XIV or short VXX instead of or in addition to ramping up SPY exposure. I recently did some research that looked at the possibility of shorting VXX rather than buying SPY based on Aggregator signals. I will look to generate a presentation based on that research in the next day or so. I hope to be able to hold a webinar on it on Thursday for subscribers. The webinar will be recorded and it will create a new page in the videos section of the site so that subscribers may refer back to it in the future. Invites for the webinar will likely be sent out on Wednesday assuming I have managed to complete the presentation.

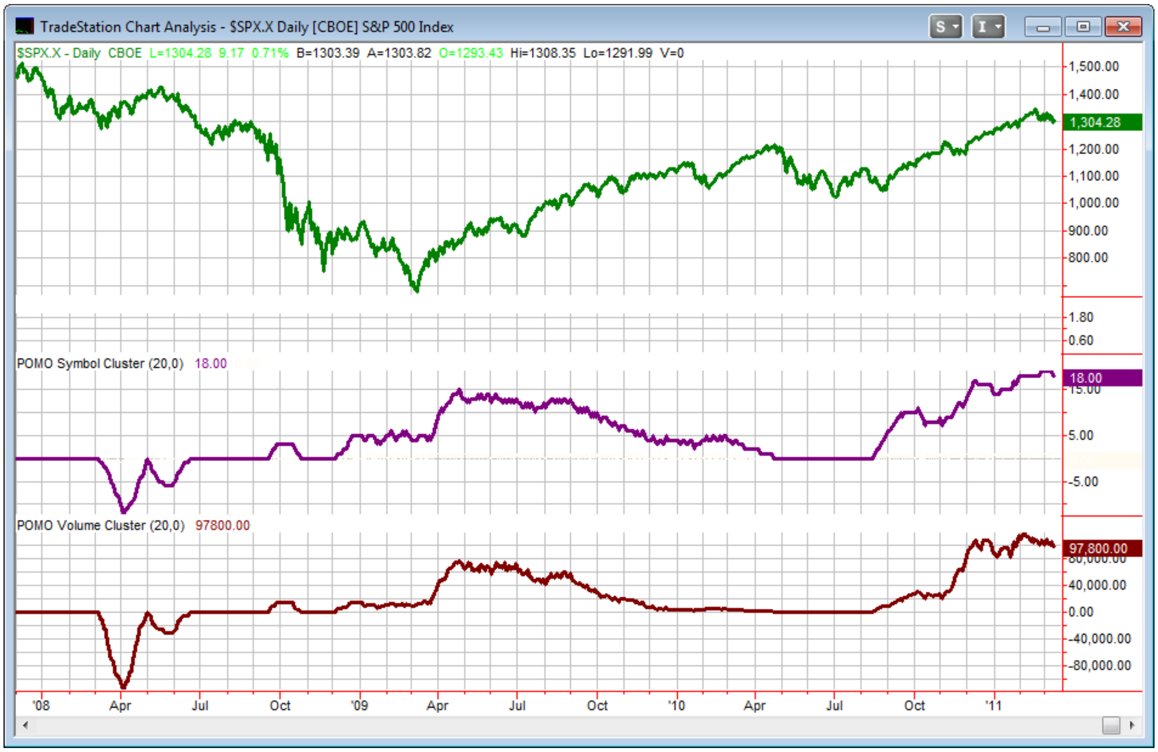
Intermediate-term Outlook (2 weeks – 2 months)– updated 3/14 - bullish

It was a difficult week for the market. From a technical standpoint the big news was the triangle breakdown on Thursday. This was seen by many as a potential topping event indicating further selling. This is not what my research showed though. The triangle breakdown study I published Thursday night suggested a strong intermediate-term upside bias. All (non-trial) subscribers can find the triangle studies, as well some additional performance reports and Tradestation code in the downloads section of the website.

I've been updating the POMO chart most weekends in the letter. For those who may not recall below is a brief refresher on POMO. Beneath that I have updated our POMO indicator chart.

POMO stands for Permanent Open Market Operations and it is how the Fed goes into the open market to buy securities. The net effect of this buying is an influx of cash into the system. It appears a portion of that cash makes its way to the stock market and works as a bullish influence. A "POMO Day" is simply a day where these operations take place… The chart below (shows a couple of POMO indicators). The top pane is the S&P 500. The middle pane is the rolling number of days in the last 20 that have been POMO days. The bottom pane is the total amount of money infused into the system over the previous 20 days. Information on acquiring the data and constructing the chart can be found in the January 3rd POMO presentation linked below. (Not available for trial users.)

http://www.quantifiableedges.com/members/pomo.php



The POMO Days indicator is still extremely elevated at 18. The Fed released the new tentative operations schedule on Thursday. It doesn't appear quite as busy as the last couple of months but there is still buying scheduled for around 4 days per week. This upcoming week Tuesday is the only non-POMO day. The POMO Volume indicator has dipped a little bit but is still at a very elevated level, with plenty of money having gone in to the system over the last month. I expect POMO to continue to provide a steady wind at the market's back. For those that would like to view the upcoming schedule I have provided a link below.

http://www.newyorkfed.org/markets/tot_operation_schedule.html

I still feel odds favor a continued rise over the next several weeks. POMO, trend, momentum, and price patterns (including the new triangle breakdown study) all suggest the rally is not over. There also continues to be a complete lack of intermediate-term bearish evidence. Due to this, I still favor a bullish outlook. From my standpoint this means I'll trade the long side more aggressively and the short side more conservatively.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

HPQ –1/3 @ $43.59
HPQ –1/3 @ $42.17
XOM – 1/3 @$81.31

Catapult for ETF's Trades

None

***Broad Market Large Cap CBI* – 3 (HPQ-2, XOM)**

Additional New Trade Ideas

A full listing of system triggers can be found at the system triggers page each night. I will cherry pick some of my favorite setups from the S&P 100 and ETF lists along with occasional other trade ideas to track below.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
HPQ (1/3)	2/24/2011	$43.16	$41.49	-3.87%		Catapult
SPY(1/4)	3/8/2011	$131.43	$130.05	-1.05%		Aggregator
SPY(1/4)	3/11/2011	$129.52	$130.05	0.41%		Aggregator
HPQ (1/3)	3/11/2011	$41.42	$41.49	0.17%		Catapult
XOM(1/3)	3/11/2011	$81.02	$82.38	1.68%		Catapult